Before the

FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of Petition for Forbearance From The Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) Of The Commission's Rules	**CC Docket No. 96-149**

Ex Parte Declaration

of

LEE L. SELWYN

on behalf of

AT&T Corp.

July 9, 2003

EX PARTE DECLARATION OF LEE L. SELWYN

TABLE OF CONTENTS

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Introduction

1. My name is Lee L. Selwyn; I am President of Economics and Technology, Inc. ("ETI"), Two Center Plaza, Suite 400, Boston, Massachusetts 02108. I have previously submitted an *ex parte* Declaration in this matter on behalf of AT&T Corp. on March 15, 2003; my Statement of Qualifications was attached thereto. I have been asked by AT&T to review certain recent *ex parte* filings made by Verizon, and to offer an opinion as to the content thereof.

Background

2. The Commission has interpreted the 47 U.S.C. §272(b)(1) "operate independently" requirement as prohibiting a BOC's ILEC entities and Section 272 affiliates from (a) sharing operations, installation and maintenance ("OI&M") functions, and (b) jointly owning switching and transmission facilities and the associated land and buildings.[1] In its *Petition* filed August 5, 2002, Verizon asked the Commission only to forbear from enforcing the OI&M prohibition.[2] Verizon asserts that if the various OI&M functions that are currently being performed by the affiliates on a stand-alone basis were instead to be performed by its ILEC personnel utilizing facilities that are fully integrated with ILEC network operations, the Verizon Section 272 affiliates would realize ongoing savings of $247-million over the coming three years.[3] Although Verizon

1. *Implementation of the Non-Accounting Safeguards of Section 271 and 272 of the Communications Act of 1934, as Amended,* 11 FCC Rcd 21905, 21981-21982 (1996).

2. *Petition for Verizon for Forbearance From the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) of the Commission's Rules*, CC Docket No. 96-149, Petition for Forbearance, filed by Verizon, August 5, 2002. Significantly, the Table used by Verizon to establish "Incremental Operating Expenses Driven by Structural Separation" in its *ex parte* filings is not limited to the OI&M restriction. *See*, Verizon's June 4, 2003 *ex parte*, Attachment 3, p. 2, Table 1; *see also*, June 24, 2003 *ex parte,* at 8, Table 1. There Verizon identifies, for example, "Leased facilities" as one of those expenses, asserting that "[w]ithout section 272 restrictions, VZ would have built rings instead of leasing facilities (both for use by GNI and by the local exchange company)." Of course, that expense is driven by the joint ownership prohibition of Section 272(b)(1), not by the OI&M restriction.

3. *Petition for Verizon for Forbearance From the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) of the Commission's Rules*, CC Docket No. 96-149, Declaration of Fred Howard, filed by Verizon, August 5, 2002. In fact, Verizon would never realize the full extent of the savings it purports to have projected. Verizon's analysis is based upon historical data. However, Verizon is already permitted to operate its local
(continued...)

had advanced specific dollar figures for the claimed savings in its August 5, 2002 *Petition*, the Company provided no data or analysis in support of such claims. Apparently at the request of the Wireline Competition Bureau, Verizon has now submitted documents, in the form of several *ex parte* filings made on May 19, June 4, and June 24, 2003, as well as documents transmitted via letter to AT&T dated June 2, 2003, that purport to provide "support" for its "savings" forecast.

Verizon's latest *ex parte* submissions advance no new facts or other evidentiary support for the cost "savings" that Verizon claims would result from elimination of the "operate independently" requirement.

3. At the request of AT&T, I have reviewed the three Verizon *ex parte* submissions, and conclude that they offer no additional substantive facts or analyses than had been present in the original *Petition*. In these submissions, Verizon purports to calculate the "costs" that (it contends) the OI&M rules impose upon Verizon's Section 272 affiliate, Verizon Global Network Inc. ("GNI"). The essence of Verizon's "analysis" is a series of irreproducible and largely

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3. (...continued)
and long distance OI&M services on an integrated basis in New York, where the FCC has allowed the requirements of Section 272(b)(1) to sunset. FCC Public Notice, "Section 272 Sunsets for Verizon in New York State By Operation of Law On December 23, 2002 Pursuant to Section 272(f)(1)," rel. December 23, 2002. As I discuss in more detail, *infra*, at paras. 3-4, because Verizon has provided no workpapers or other data or documentation underlying its cost savings calculation, the estimate can neither be reproduced nor verified. That said, nothing in Verizon's *Petition* or in its various *ex parte* filings would indicate that there had been any allocation of the purported cost savings to (or other than to) New York, or any discussion of excluding New York expenses from GNI accounts for the purposes of determining cost savings. Therefore, it would appear that the GNI accounts include OI&M costs for which no forbearance is required, or expense savings that could (presumably) be obtained without the regulatory relief being sought here. In either case, these putatively structural separations-driven expenses should not have been included in Verizon's analysis.

undocumented "percentages of each GNI expense category that Verizon claims had been driven by the requirements of the Commission's section 272 structural separations rules" pertaining to OI&M.[4] Each of these "percentages" are then applied to the dollar value of the GNI expenses in each category, respectively, from which Verizon then calculates what purports to represent, in each case, the "incremental operating expenses driven by structural separation." No workpapers or other documentation underlying the calculation of the proffered percentages or the specific expense amounts to which they had been applied were included in any of the Verizon *ex parte* submissions.

4. By its own admission, however, each of these percentages was developed from "assumptions" ostensibly made by "[s]ubject matter experts representing GNI Operations, Information Technology, Engineering, and Business Services."[5] No documentation explaining how the specific numerical values of the various percentages had been arrived at by the subject matter experts, what facts they had relied upon, what analyses they had conducted, what efforts had been made by the subject matter experts or other Verizon personnel to examine or verify the reasonableness of the "assumptions" that had been utilized, or any other aspects of the underlying work, were provided by Verizon. Nor is the "study" verified by an affidavit. Other than the

4. June 24, 2003 *ex parte*, at 6. GNI provides the wholesale network operations functions to Verizon's three separate *retail* Section 272 long distance affiliates, Bell Atlantic Communications, Inc. (BACI) d/b/a Verizon Long Distance (VLD), NYNEX Long Distance Company (NLD) d/b/a Verizon Enterprise Solutions (VES), and Verizon Select Services Inc. (VSSI) f/k/a GTE Communications Corporation. June 4, 2003 *ex parte*, at Attachment 1.

5. *Id.*, at 6-7.

slightly-lengthened verbal descriptions of the "assumptions" that were made with respect to each expense category, however, this latest round of Verizon *ex parte* submissions presents no new facts or quantitative analyses beyond what had been included with the original August 5, 2002 *Petition*. Without such documentation, workpapers, supporting facts and analyses, there is no possibility for any independent reproduction or validation of the proffered "savings" projections, which must, for that reason, be afforded no weight by the Commission.

Beyond its numerous methodological infirmities, Verizon's latest "analysis" focuses solely and exclusively upon "savings" that would be realized by its Section 272 affiliates, ignoring entirely the additional costs that would necessarily be absorbed by its ILEC entities as they assume responsibility for GNI's OI&M functions.

5. What does emerge from the June 24 submission is a clarification of the limitations of even this highly superficial analysis and, in particular, the fact that it fails even to provide a complete exposition of what it purports to present. Specifically, Verizon's "analysis" focuses solely and exclusively upon expenses that are incurred by its Global Networks, Inc. ("GNI") affiliate ostensibly as a result of the OI&M structural separation requirement; *nowhere does Verizon even attempt to examine the level of costs that the Verizon ILECs do not incur by virtue of the fact that GNI is responsible for its own OI&M*. By Verizon's own admission, its "subject matter experts" were in all cases *employees of GNI* and for each expense category were asked to estimate costs that had been "reported monthly by GNI's finance group."[6] Nowhere in Verizon's work-up of

6. *Id.*, at 7.

these "structural separation driven costs" is there any indication that ILEC OI&M subject matter experts, financial experts, or financial reports were either consulted or considered.

6. To the contrary, what Verizon has actually done is to *assume* that if integrated into ILEC OI&M activities, the various functions performed by the Verizon ILECs for the benefit of GNI "could be *absorbed* by the existing [ILEC] staff of local exchange carrier technicians" and that the ILEC resources are "sufficiently large to *absorb* the incremental work."[7] The theory here seems to be that because the separate Section 272 affiliate is so small relative to the ILEC, the additional demands that would be placed upon the ILEC's personnel, systems and other resources would be so inconsequential to the total ILEC operation as to constitute little more than the proverbial "drop in the ocean."

7. Moreover, from the verbal discussion in the June 24 filing, one is compelled also to conclude that GNI does not expect to actually "pay" the Verizon ILECs, or impute into its own operations, the costs for the ILEC resources used for performing any of these "drop in the ocean" functions on GNI's behalf.[8] Presumably, if such payments were anticipated, they would have

7. *Id.*, emphasis supplied.

8. GNI notes, in its June 4 *ex parte* filing, at 2, that the Section 272(c)(1) non-discrimination obligations would apply: "If a Verizon BOC offers OI&M services to Verizon's Section 272 affiliates, it will be required to offer the same service to other carriers on a nondiscriminatory basis." In order for GNI to realize these savings, the ILEC would have to charge its Section 272 affiliate the ILEC's incremental cost for these services. However, Verizon also notes in the same June 4th *ex parte* that under the circular "prevailing price" definition, "any price charged by the ILEC will be considered to be the prevailing price." Based upon this statement, and the fact that
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been captured in any *pro forma* financial reports that the GNI subject matter experts would have developed as part of their undertaking. Even with "perfect" price cap regulation, Verizon has a strong incentive to shift costs to the regulated ILEC entity so as to evade the requirements of imputation. That is, by "lowering" the affiliate's "costs," Verizon is in a better position to effect a price-cost squeeze. Price cap regulation without sharing of excess earnings or an earnings cap (so-called "pure" price caps) makes the BOC's parent corporation financially indifferent as to whether a particular cost is booked to the ILEC entity or to a nonregulated affiliate. This provides a BOC with three additional reasons to shift costs to the ILEC, wherever possible:

(1) The higher ILEC costs resulting from large quantities of spare or excess capacity can be advanced by the ILEC to justify higher prices for essential (bottleneck) services furnished to downstream competitors (access and UNEs);

(2) The lower affiliate costs will enable the affiliate to be competitive with respect to those aspects of its operations that compete directly with downstream rivals; and

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8. (...continued)
GNI estimates appear not to have included *any* ILEC costs attributable to the ILECs' assumption of these functions, it would seem that the ILECs would be providing OI&M services to the Section 272 affiliates at a "prevailing price" equal to the ILECs' short-run incremental cost, which would itself be based upon the "absorption" concept. In theory, of course, Verizon will be required to offer to provide the equivalent OI&M functions to nonaffiliated entities at the same "prevailing company prices." However, as I discuss in more detail, *infra,* at paras. 20-21, Verizon has offered no explanation as to how it would confer the same efficiencies of OI&M integration to a nonaffiliated carrier as it claims it can only achieve with respect to its own affiliates only by transferring the affiliates' OI&M functions to the ILECs.

(3) By raising ILEC costs overall, the BOC paves the way for maintaining or increasing access charges once the *CALLS* rate freeze has expired, or for the reinitialization of a state price cap plan.

8. According to Verizon's June 24 filing, the subject matter expert group apparently based this "absorption" theory upon headcounts of ILEC vs. Section 272 affiliate personnel: "GNI employs 34 technicians compared to thousands employed by the local exchange carrier"[9] Likewise, Verizon explains that "[t]here are enough local exchange carrier technicians in geographical areas where GNI has built its Hubs and POPs that the work could be absorbed by the existing staff of local exchange carrier technicians."[10]

9. A simple example shows the flaw in this logic. With regard to Professional Services, Verizon states that "almost all (95 percent) of the professional services expenses were driven by section 272 requirements." The ability for the ILEC to "absorb" the incremental Professional Services work related to GNI operations while incurring only 5% of the costs of the Section 272 affiliate, however, has little to do with the number of employees engaged in this work at the two entities, but rather the utilization and productivity of the respective employees. If it is actually the case that the ILEC can, for only 5% of the cost of the affiliates' self-provisioned service, do the incremental work currently being handled by 34 technicians with no increase in ILEC work forces, then the ILEC is *not* working efficiently. The presence of such inefficiencies in the

9. June 24 *ex parte*, at 7.

10. *Id.*

Verizon ILEC operations is hardly a basis for the Commission to forbear from enforcing a statutory requirement whose sole purpose is to limit the BOCs' ability to leverage their local service monopolies to gain market power in the adjacent long distance market through discrimination in favor of their affiliate and through misallocation of the costs of joint operations. Indeed, if the Commission were to afford any weight whatsoever to Verizon's "absorption" theory, it would encourage BOCs to deliberately instill inefficiencies by deliberately building up excess capacity into their ILEC operations, impose the costs thereof upon captive customers of monopoly services (including carrier access services and UNEs), and then seek integration authority so as to utilize the inefficient excess capacity for the benefit of nonregulated affiliates while retaining the costs thereof largely or entirely within the regulated ILEC entities.

10. Verizon's theory that its ILECs have sufficient capacity to "absorb" GNI's OI&M demands also cannot be squared with the statement, at page 9 of its June 24 *ex parte* filing, that "GNI's traffic volumes continue to grow substantially." According to Verizon, GNI traffic volumes are projected to grow by a substantial amount between 2001 and 2003, and Verizon further states that "[t]his is a conservative projection, as GNI has already exceeded its quarterly projection for the first quarter of 2003." Verizon claims to be the third largest US long distance carrier based upon the number of presubscribed customers, and has most recently reported that some 13.2-million customers have signed up for Verizon long distance service.[11]

11. Verizon Corp. First Quarter 2003 Quarterly Bulletin, April 22, 2003, at 4.

Verizon's assumption that its ILECs have sufficient existing capacity to "absorb" GNI's OI&M demands would ascribe to GNI no more than the short-run incremental cost of these newly integrated functions, which would be less than TELRIC-based prices that Verizon charges to its CLEC competitors for unbundled access to its network.

11. That Verizon would here advance this "absorption" principle as the basis for its expense savings claim is particularly remarkable in light of Verizon's persistent contention that the Commission's Total Element Long Run Incremental Cost ("TELRIC") requirements fail to adequately compensate the Verizon ILECs for services furnished to CLECs on an unbundled basis. Verizon has repeatedly argued that prices set at TELRIC fail to recover the "actual costs," as reflected on its books, that it incurs in providing unbundled network elements ("UNEs").[12] Incredibly, Verizon's newly-minted "absorption" theory would not produce transfer prices (if any) that were well below those that would emerge from application of TELRIC. Here, the GNI subject matter experts have premised their "costs driven by structural separation" analysis by looking solely to the Verizon ILECs' *short-run incremental costs* which, if not expressly identified as being incremental to the affiliates' operations, they then apparently assume to be zero!

12. In fact, Verizon's operating expense "analysis" is totally at odds with the basic costing principles inherent to the Commission's TELRIC methodology. As expressed in the Commission's seminal order adopting TELRIC:

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12. *See, e.g., Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, *Deployment of Wireline Service Offering Advanced Telecommunications Capability*, CC Docket No. 98-147, *Comments and Contingent Petition for Forbearance of the Verizon Telephone Companies*, April 5, 2002.

> Costs must be attributed on a cost-causative basis. Costs are causally-related to the network element being provided if the costs are incurred as a direct result of providing the network elements, and can be avoided, in the long run, when the company ceases to provide them.[13]

By limiting its analysis to the short run only, Verizon ignores the fact that, in the long run, the ILEC excess capacity that it assumes is available for use by GNI (i.e., the technical staff, back office systems, etc.) ultimately must be replenished, and thus must be considered as a cost *caused by* and thus attributable to GNI. In the long run, all costs and capacities are variable, and there is no "free" "excess capacity" that is available to be "absorbed."

13. Moreover, the Commission must seriously question whether the Verizon ILECs presently have excess capacity in their work forces, systems, and other resources that are already sufficient to fully "absorb" the additional GNI demands. There is certainly no evidence in either the Verizon *Petition* or in any of its *ex parte* filings to support this claim. There are, however, several possibilities, any of which work to fundamentally undermine Verizon's OI&M integration claims:

(1) *The Verizon ILECs do not, in fact, have any excess capacity.* In that case, any shift of OI&M demand from GNI to the ILECs would engender additional costs to the ILECs, rendering invalid the asserted expense savings resulting from OI&M integration.

13. *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket Nos. 96-98 and 95-185, *First Report and Order* (released August 8, 1996), ("Interconnection Order") at para. 691, 11 FCC Rcd 15499, 15851.

(2) *The Verizon ILECs have sufficient excess capacity to satisfy GNI's needs.* This possibility is, of course, inconsistent with the assumption that price cap ILECs are operating efficiently. Verizon and its predecessor companies in the past have offered analyses to both the FCC and state PUCs purporting to show that its realized earnings levels for price capped services had deteriorated, as evidence that the X-factors in those plans had been set too high and should be reduced or eliminated altogether.[14] If Verizon has pursued a policy of consistently maintaining excess capacity, that would have explained the apparently low productivity growth that Verizon claims to have experienced, and would have resulted in higher rates for monopoly services, all else being equal, than would have prevailed had such excess capacity not been present and the resulting productivity growth had been greater. Verizon's latest effort to shift this excess ILEC capacity to the uncompensated benefit of its Section 272 affiliates would thus constitute an unlawful cross-subsidy of the competitive services being provided by the affiliates funded by excessive prices for Verizon's regulated monopoly ILEC services.

14. See, e.g., CC Docket No. 94-1, Reply Comments of Bell Atlantic, March 1, 1996; CC Docket Nos. 96-262 and 94-1, Bell Atlantic Comments on Further Notice, January 7, 2000; Massachusetts D.T.E. Docket No. 01-31 (Phase I), Initial Brief of Verizon Massachusetts (Public Version), February 12, 2002; Pennsylvania Public Utility Commission Docket No. P-00001854, Prepared Rebuttal Testimony of Robert J. Mcgonagle on behalf of Verizon North Inc., February 20, 2001.

Verizon's "absorption" theory runs counter to the cost allocation requirements at Part 64 of the Commission's Rules.

14. Verizon's "absorption" theory also runs directly counter to the Commission's cost allocation requirements at 47 CFR § 64, which require apportionment of costs between regulated and nonregulated ILEC services on the basis of fully distributed cost. If excess capacity is present in the Verizon ILECs as the GNI subject matter experts have assumed, the Commission's cost allocation rules would require that the costs of that excess capacity be spread ratably across all utilized capacity, rather than being made available, without charge, to the nonregulated affiliate.

15. Subpart I of Part 64 requires carriers to separate the costs of regulated activities from those of nonregulated activities, and sets forth broad rules for allocating such costs. The cost allocation rules also provide that a telecommunications carrier may not use services that are not competitive to subsidize services subject to competition.[15] However, even if one could assume Verizon's complete technical compliance with the principles set forth at Part 64, these rules leave substantial room for improper and anticompetitive allocation of costs whenever regulated and nonregulated activities take place on a fully integrated basis.

16. Carriers are required to assign costs directly to regulated or nonregulated activities "whenever possible."[16] The Commission's rules recognize, however, that not all of a carrier's

15. 47 CFR § 64.901(c)

16. 47 CFR § 64.901(b)(2)

costs are directly assignable. Under Part 64, all costs not directly assignable are considered "common" costs. The rules require the carrier to group common costs into "homogeneous cost categories" and then assign each cost category based upon a "hierarchy" of cost allocation principles:

(i) Where possible, the carrier must allocate a category of common costs "based upon direct analysis of the origin" of those particular costs.

(ii) If this is not possible, the allocation shall be based upon an "indirect, cost-causative linkage to another cost category (or group of cost categories) for which a direct assignment or allocation is available.

(iii) If neither of the first two methods are feasible, then the carrier must use "a general allocator computed by using the ratio of all expenses directly assigned or attributed to regulated and nonregulated activities."

If these rules are not vigorously enforced, they leave Verizon with significant discretion that can be used to shift costs from GNI to its regulated activities. Moreover, although Part 64 requires the ILECs to provide a more detailed explanation of their actual cost allocations in their cost allocation manuals ("CAMs"), there has been little scrutiny of the CAMs. Cost accounting abuses ultimately uncovered in a biennial audit can often be "too little, too late" to redress the harm to competition that occurs from cost misallocation in the intervening period.

17. In the case of central office equipment and outside plant investment, Part 64 requires that costs be assigned based upon relative use by regulated and nonregulated activities.[17] However, since an allocation based solely upon relative usage is "blind" to other cost causative factors, it can provide opportunities for cost shifting between regulated and nonregulated activities. Take, for instance, the following example. A Verizon ILEC provides service to a community using copper loops that are provisioned exclusively for POTS; this original outside plant is valued at $100,000. As currently provisioned, this outside plant cannot be used to provide high-speed Internet access service. The ILEC decides to deploy fiber in order to support advanced services, such as high-speed Internet access, which are nonregulated services being provided by an affiliate. Once deployed, however, the replacement outside plant, which has a cost of $300,000, will also be used to provide POTS, which will in fact account for 90% of the usage on these loops. Prior to the "upgrade," the ILEC's regulated POTS service is required to support 100% of $100,000. As a consequence of the upgrade, POTS will get a cost allocation of 90% of $300,000, i.e., $270,000, while the nonregulated services that drove the investment decision will pick up only $30,000. The regulated activity is $170,000 worse off, bearing costs that are not necessary for the functionality of the regulated service, whereas the nonregulated activity receives the benefit of a $300,000 outside plant upgrade for a mere 10% of that cost.

18. If the existing OI&M restriction is eliminated, one can readily imagine a comparable scenario. Suppose that in order to capture GNI's OI&M functions, the Verizon ILECs must

17. For purposes of this allocation, the carrier must look at usage in each of three calendar years ("beginning with the calendar year during which the investment usage forecast is filed") and use the ratio from the year in which the relative usage by nonregulated activities was the greatest.

undertake broad upgrades to their existing operations support systems ("OSS"), at a cost of $100-million. However, once completed, the upgraded OSS will be utilized on an integrated basis to support traditional POTS and affiliate long distance and other services. As a result, Verizon could attempt to treat the $100-million upgrade and subsequent ongoing maintenance expenses as a "common" cost, and so "allocate" it on some sort of relative use basis as between its POTS and long distance operations. *Any non-zero allocation of these incremental system development and maintenance costs to POTS would have the effect of shifting costs away from the competitive long distance operations and onto regulated monopoly local exchange services*.

19. If excess ILEC capacity is not present, it is entirely possible that a shift of OI&M functions from the affiliates to the ILECs could also result in a net *increase* in costs being allocated to monopoly ILEC ratepayers than under the existing separated OI&M arrangement. This would occur if, for example, the ILEC were required to construct or acquire a block of additional capacity to serve the affiliate (or even to accept a transfer of capacity from the affiliate) that would not be fully utilized within the three-year usage allocation time frame contemplated at 47 CFR § 64.901(b)(4). In such a case, the excess spare capacity might be disproportionately allocated to monopoly services until such time (in the more distant future) when it is placed in active use in support of nonregulated services. Due to the utter absence of any data or other facts pertaining to the impact of OI&M integration *upon the Verizon ILECs*, there is nothing in Verizon's submissions would permit the Commission to affirmatively establish that such an outcome would not arise.

Verizon has not demonstrated that it will be able to achieve the specific efficiencies that Verizon projects to result from OI&M integration without directly violating the nondiscrimination requirements of Sections 272(c) and 272(e)(1).

20. The existing OI&M structural separation requirement has the effect of creating comparability in the interactions between the Verizon ILECs and Verizon's Section 272 affiliates and those confronting nonaffiliated IXCs and CLECs in their dealings with the Verizon ILECs. Under the existing separated arrangementment, orders initiated by customers of the affiliate must first flow through the affiliate's OSS before being transmitted to the ILEC. The formal process for such transmission, in the case of IXC private line services, is the Access Service Request ("ASR"). The affiliate (or a nonaffiliated IXC) prepares an ASR and transmits it to the ILEC, which receives it, validates it, and based thereon proceeds to process the service order. Although less than specific in its details, Verizon's vision of OI&M integration contemplates that customer service orders initiated by its affiliate would instead be communicated directly (through an unspecified, apparently informal channel) to the ILEC for processing, which would include, among other things, preparation of the ASR by the ILEC itself.[18]

21. Much of the "savings" that Verizon seeks to ascribe to OI&M integration appears to arise from the potential for the Verizon Section 272 affiliate to bypass many of the formalities that have

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18. Verizon's June 24 *ex parte* includes "Example 3" outlining the ordering and provisioning process flow Verizon would implement should it receive forbearance. In this process flow, six functions usually performed by GNI (or competing IXCs) could be contracted to ILEC personnel. These services include creation of the private line order, creation of the ASR for the access circuit, design of the interLATA component, provision of the interLATA network, notification of firm order confirmation and design layout record, and test and turn-up of the circuit.

been established for interactions between the Verizon ILECs and IXCs (or CLECs). Yet to comply with the nondiscrimination requirements at Sections 272(c)(1) and 272(e)(1) and (2), Verizon would have to offer the same "bypass" opportunities to competing IXCs and other nonaffiliated telecommunications carriers. This requirement suggests two possible scenarios, neither of which has been specifically addressed in any of the Verizon *ex parte* submissions:

(1) In order to comply with Sections 272(c) and (e) following OI&M integration, Verizon would also need to allow nonaffiliated companies to similarly bypass the formal service ordering/provisioning processes and instead provide the nonaffiliated carriers with the same direct access to ILEC personnel and systems that would exist for its own affiliate under OI&M integration. Verizon has not, of course, stated that it either would or could do that; indeed, if such informal, direct access could be provided to nonaffiliated carriers who are clearly not otherwise "integrated" with the Verizon ILEC with respect to OI&M, then this could be accomplished without the requested forbearance by the Commission. Indeed, if in fact Verizon would provide nonaffiliated ILECs with such informal access as a condition for approval of its OI&M *Petition*, that would simply confirm the long-held view that the formal ASR/LSR transmittals were never really necessary in the first place, but were introduced by Verizon as a means both for increasing its rivals' costs and for slowing down their service ordering/provisioning processes.[19] In that event, the putative

19. This would be analogous to the requirement, adopted in the wake of the Commission's 1968 *Carterphone* decision, that customer-provided terminal equipment be interconnected with the public telephone network via so-called "Protective Connecting Arrangements" ("PCAs"). *Use of*
(continued...)

gain in efficiency ostensibly arising from OI&M integration is not so much the result of actual integration efficiencies, but rather from the elimination of contrived *inefficiencies* that had been artificially introduced into the system.

(2) Alternatively, if Verizon is unable to provide a means for nonaffiliated carriers to bypass the formal ASR/LSR transmittal processes, Verizon would then be unable to satisfy the Sections 272(c) and (e)(1) nondiscrimination requirements, since it would then be affording its affiliates superior (informal) access to its systems and personnel that would be unavailable to its nonaffiliated rivals.

It is, in fact, difficult to see how Verizon's contentions regarding its own efficiency gains under OI&M integration can be squared with the overarching Section 272(c)(1) requirement that it "not discriminate between that company or affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or in the establishment of standards" and the Section 272(e) requirements that it "(1) shall fulfill any requests from an unaffiliated entity for telephone

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19. (...continued)
the Caterfone Device in Message Toll Telephone Service, FCC Docket No. 16942*, Thomas F. Carter and Carter Electronics Corp. (Complainants), v. AT&T et al (Defendants)*, Docket No. 17073, *Decision*, 13 FCC 2d 420 (1968). As subsequently determined by the federal courts, PCAs had no function or purpose other than to impose additional costs upon competitors in the nascent CPE market. *See e.g., Litton Systems, Inc. v. Am. Tel. & Tel. Co.,* 700 F.2d. 785 (2nd Cir., 1983). I and others have previously argued that ILECs could provide nonaffiliated carriers with direct access to their OSSs without cumbersome and error-prone manual or off-line electronic interfaces. Although it has not in fact conceded that it would actually do this as a condition for OI&M integration, that possibility certainly raises serious concerns as to the veracity of Verizon's purported compliance with Sections 251, 252 and 271(c)(2)(B).

exchange service and exchange access within a period no longer than the period in which it provides such telephone exchange service and exchange access to itself or to its affiliates" and "(2) shall not provide any facilities, services, or information concerning its provision of exchange access to the affiliate described in subsection (a) unless such facilities, services, or information are made available to other providers of interLATA services in that market on the same terms and conditions." *By definition*, the specific efficiency gains being envisioned by Verizon would in each case be limited solely to its own affiliate and not be offered or available to nonaffiliated rivals. The fact that Verizon might (arguably) be forced to incur costs that might otherwise be avoided through integration does not justify a wholesale abandonment of the multiple statutory nondiscrimination requirements.

Verizon has not shown that *any* integration efficiencies would result from elimination of the "operate independently" requirement.

22. Verizon's focus solely and exclusively upon the impact of the structural separation requirement upon GNI cannot and does not support Verizon's claim that structural separation is burdensome to the corporation as a whole or that it is wasteful of societal resources. Verizon has not shown that *any* integration efficiencies would result from elimination of the OI&M portion of the "operate independently" requirement; it is only (perhaps) demonstrated that the costs that would be *assigned* to GNI would be reduced. Indeed, Verizon's own *voluntary* actions with respect to its separate Section 272 affiliates belies any claim of actual integration efficiencies. Verizon has decided to *voluntarily* create five different Section 272 Affiliates, each with its own OI&M resources, despite being under no statutory obligation to have more than one. Two of these

five separate affiliates are facilities-based wholesale service providers, Verizon Global Solutions and Global Network Inc., that apparently each operate switching facilities in the same cities — New York and Los Angeles.[20] There is nothing in Verizon's submissions that would indicate that GSI and GNI have themselves taken any initiative to integrate their respective OI&M functions. The obvious difference between the GSI/GNI situation and the GNI/ILEC case lies in the fact that because of their roughly equal size, there is no "absorption" benefit that would result from GSI/GNI integration, which may perhaps explain why it has not occurred. Clearly, Verizon's OI&M integration strategy is aimed not so much at achieving substantive integration efficiencies, but rather upon shifting costs out of its Section 272 affiliates and over to its ILECs.

Conclusion

23. Nothing in Verizon's recent *ex parte* submissions provides new substantive facts or evidence to support Verizon's claimed cost savings from OI&M integration. What the new material does confirm is that Verizon's entire claim is premised upon the entirely unsupported "assumption" that substantial portions of GNI's OI&M requirements could be "absorbed" within *existing* ILEC OI&M systems and personnel resources, and where such "absorption" has been assumed, Verizon ascribes no "cost" to GNI for the OI&M functions that would be performed on its behalf by the ILEC entities. Moreover, most of the actual integration efficiencies that are described by Verizon result from the elimination of formal transmittals between GNI and the ILECs, to be replaced by largely unspecified, informal communications mechanisms. The use of

20. June 24 *ex parte,* at Attachment 1.

such informal arrangements as between the Verizon ILECs and their Section 272 affiliates will surely result in discriminatory treatment of nonaffiliated IXCs and CLECs unless these other entities are similarly permitted to participate in the same informal processes. Verizon has not provided any indication that this will be permitted; indeed, if it *could* be permitted, then Verizon would need to explain, which it has not done, why formal integration of its affiliates' and its ILECs' OI&M functions is required if nonaffiliated (and by definition non-integrated) entities could be afforded similar treatment. Allowing Verizon to integrate its affiliate and ILEC OI&M functions will afford its affiliates with unique competitive advantages that will violate the nondiscrimination requirements of Section 272(c) and (e).

VERIFICATION

The foregoing statements are true and correct to the best of my knowledge, information and belief.

Lee L. Selwyn